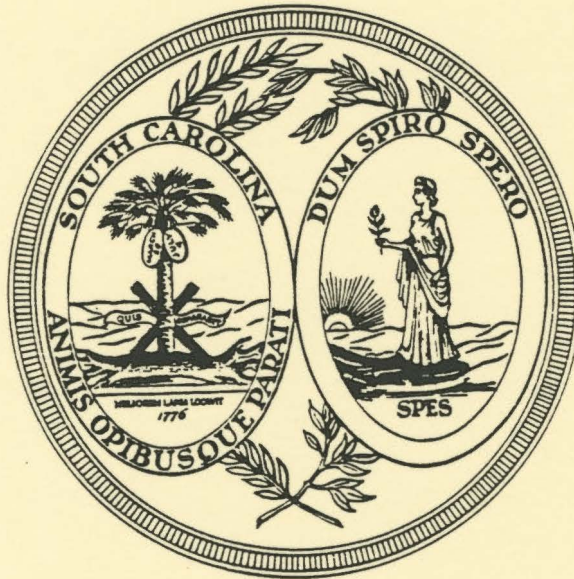


LAC

Report to the General Assembly

July 1989

A Review of the Relationship Between USC and its Foundations and USC Discretionary Spending



S. C. STATE LIBRARY
JUL 13 1989
STATE DOCUMENTS

LAC

Report to the General Assembly

Contents

Executive Summary

1

Chapter 1 Introduction and Background

Audit Request and Objectives	6
Scope and Methods.....	6
Previous Review of Foundations.....	7
Background of Foundations	7
Foundations Reviewed	8

Chapter 2 Foundation Organization and Fund-Raising

Selection of Foundation Board Members.....	11
Relationship Between USC Staff and Foundations.....	13
University Employees Working for University Foundations.....	13
Potential Conflicts of Interest.....	14
Fund-Raising Support for Foundations.....	15
Office of Alumni and Development.....	15
USC School of Medicine Clinical Faculty Practice Plan ...	16
Practice Plan Fees Support Foundation.....	17
Disposition of Donations	18
Shared Identity.....	19

Chapter 3 Business Transactions

State Funding of Private Projects	21
1. Development of Fine Arts Center.....	21
2. Development of Engineering Center	23
3. Agreement with Independent Theatre Organization...	25
Terms of Leases.....	26

Chapter 4 Foundation Oversight and Compliance Issues

Access to Foundation Records.....	30
Oversight of Private Contributions.....	34
Compliance With Appropriation Act.....	34
Status of Private Pledges.....	35
Reporting of Salary Supplements.....	37
Reasons for Separate Foundations.....	39

Chapter 5 USC Discretionary Funds

Discretionary Fund Expenditures.....	43
Confidential Records.....	45
Nondisclosure of Certain Records.....	45
Inconsistencies in Information Kept Confidential.....	47

Appendices

A USC Comments.....	51
B Commission on Higher Education Comments.....	59

Executive Summary

Major Findings

The University of South Carolina is a public institution governed by state laws and regulations, including the Freedom of Information Act. In addition, USC is subject to legislative oversight and review by the State Auditor and the Budget and Control Board. Single-purpose, university-affiliated foundations are not subject to these provisions, although their purposes are to benefit a public institution. While foundations have provided benefits to USC, better controls are needed to govern the relationship between USC and its foundations.

State resources have been used to raise money for foundations, and state appropriations have funded foundation projects. In addition, university employees serve on foundation boards, act as foundation administrators, and receive compensation from foundations. However, the state does not have access to foundation records to determine how foundations use state resources. We examined the reasons for foundations and found that accountability could be increased without reducing the benefits derived from foundations.

Foundation Organization and Fund-Raising

The Council examined the methods by which USC-affiliated foundations select board members and raise funds. USC administrators, faculty, and members of the USC Board of Trustees serve on foundation boards, and USC controls the selection process for some board members (see p. 11).

We found that USC spends state appropriations to raise funds for two foundations (see p. 13). For another foundation, surplus fees generated by USC faculty are transferred to a foundation (see p. 17). We could find no authority in state law which allows state agencies to use state resources to raise funds for private foundations.

Business Transactions

We examined two projects into which USC entered with the understanding that they would be entirely privately funded through a USC foundation. However, after the start of these projects, the scope of the projects changed and USC requested and received state funds to assist in financing the projects. We also examined a third project which was to be entirely privately funded. Private funding did not materialize for this project, so USC financed the project with public funds. USC could spend over \$13 million in public funds for these projects which were initially to involve no state funds (see p. 21).

USC has entered into leases with an affiliated foundation which contain clauses which could be unfavorable to USC. For example, USC is obligated to renew a lease beyond its expiration date if a foundation is unable to obtain private contributions to eliminate a debt (see p. 26). Further, USC has paid a foundation approximately \$2 million to lease a building under construction (see p. 28).

Foundation Oversight and Compliance Issues

In order to better understand the relationship between USC and its foundations, we requested access to certain records of USC's largest foundation. This request was denied. Therefore, we could not adequately determine the extent to which USC and this foundation operate independently, or test for compliance with certain laws (see p. 30).

We surveyed eight southeastern states to determine their extent of oversight over private foundations associated with state institutions of higher learning. All other southeastern states have greater access to foundation records than do auditing organizations in South Carolina (see p. 32).

We examined USC's compliance with reporting requirements to the Budget and Control Board. USC has not provided the Budget and Control Board with certain reports pertaining to contributions to the Koger and Swearingen Centers, as required by the Appropriation Act. In addition, we detected

discrepancies in the amounts of pledges USC reported. We attempted to verify information USC reported to the Budget and Control Board but could not do so without foundation records (see p. 34).

USC has stated that private foundations supporting USC are essential for a variety of reasons. We examined the rationales for single-purpose, university-affiliated foundations and found that under certain circumstances there is an advantage in having foundations, rather than universities, receive donations or enter into contracts. Other rationales for foundations do not take into account that state law already allows USC to protect the identity of donors or honor restrictions on gifts (see p. 39).

USC Discretionary Funds

State law allows colleges and universities to spend profits from certain activities, such as concessions and vending machines, at their discretion provided that expenditures are in accordance with policies established by the institutions' boards of trustees. From July 1, 1984 to June 30, 1988, \$2.3 million of discretionary funds was expended by the president and senior officers of USC. These funds were expended in accordance with guidelines established by the board (see p. 43).

The USC Board of Trustees voted to keep confidential the identity of some recipients of gifts paid for by discretionary funds. However, we found that some names kept confidential did not meet the board's resolutions on confidentiality (see p. 45).

Conclusion

Although private foundations affiliated with USC have a separate legal identity, they have not operated completely independent of the university. For example:

- USC appoints many foundation board members, including all members of the Carolina Research and Development Foundation.
- USC high-level employees have served as foundation executive directors, chief financial officers, and other officers.
- Foundations are dependent on USC for much of their fund-raising.
- Certain contracts between USC and the Carolina Research and Development Foundation have not been in the best interest of USC.

While some overlap between USC and its foundations in personnel and functions may be desirable and in some cases required, increased access to foundation records would improve accountability and oversight for agency-affiliated foundations without reducing the benefits derived from foundations. We therefore recommend the following:

Major Recommendations

- The General Assembly may wish to consider amending state laws to allow for more oversight of private foundations which support state agencies. This may include requiring foundations to be subject to the Freedom of Information Act and review by the Legislature and state oversight agencies.
- As an alternative, if state funds are used to fund any part of a foundation project or program, state access to related records of the foundation should be allowed.
- The General Assembly may wish to consider clarifying whether state employees are allowed to solicit funds for private foundations, perform services for private foundations, or expend state resources for private foundations. If the General Assembly chooses to

expressly authorize this practice, legislation requiring foundations to repay the state for all fund-raising and other expenses incurred should be enacted.

- The USC Board of Trustees should reexamine discretionary fund documents which have been made confidential. In accordance with USC board resolutions, all documents except those related to the solicitation of gifts and donations should be made public.

Introduction and Background

Audit Request and Objectives

The Audit Council was requested to examine the relationship between the University of South Carolina and its private foundations. We were also asked to review the president's discretionary expenditures. In conducting this review, the Council's objective was to analyze the relationship between USC and its foundations. This review examined the extent to which USC provides support for the foundations. We also examined the benefits (as stated by USC) that foundations provide to USC. In addition, discretionary accounts were analyzed to determine the types of expenditures made and if the expenditures were in accordance with university policies and state regulations.

Scope and Methods

To conduct this examination, the Council interviewed USC and state government officials, examined documents maintained by the university and other state agencies, and surveyed other states to determine their extent of oversight of foundations. This review concentrates on USC's relationship with four affiliated foundations (see p. 8). Because USC-affiliated foundations are private entities, we had no legal access to their financial records. We requested access to certain records of the Carolina Research and Development Foundation, but the foundation denied this request. Therefore, we were only able to review documents maintained by state agencies or foundation documents which are public record. This review covers activities and management decisions during the time period from July 1, 1984 through September 30, 1988. This report was prepared in accordance with generally accepted government auditing standards.

Previous Review of Foundations

This is the second Audit Council review of controls governing foundations associated with state agencies. In a 1983 report entitled *A Review of the Relationship Between State Agencies and Associated Endowments*, the Council recommended improvements to govern the relationship between state agencies and associated foundations.

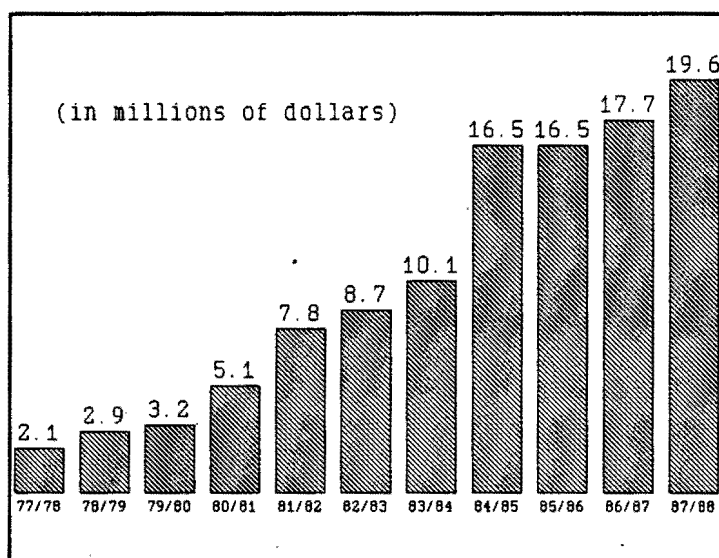
Background of Foundations

Private foundations chartered to benefit public agencies and universities are common in South Carolina and across the nation. Among the advantages of these foundations are their ability to attract donations in support of university goals and objectives. They also have greater flexibility in responding to research opportunities, and a capacity for entering into a broad range of legal and organizational relationships with other universities, business and industry. Foundations can provide for greater flexibility and expertise in investing accumulated funds. Donations either to USC or its foundations are tax deductible, so there is no tax advantage in donating to a foundation rather than to USC.

The relationship between the University of South Carolina and its affiliated foundations is a complex and mutually dependent one. Private contributions to the university are designated for student financial aid, endowed professorships, salary supplements for faculty and administrators, library acquisitions, and equipment. They have assisted in sponsoring research and constructing buildings and classrooms, and are an important part of the long-range growth and development of the University of South Carolina. *Private gifts and contributions to USC and its foundations have greatly benefited the community.*

The following graph shows the amount of private contributions and research grants given to USC and its foundations from July 1, 1977 to June 30, 1988.

Graph 1.1: Contributions and Research Grants Given to USC and its Foundations



Source: *The USC 1987-88 Report of Private Support*

Foundations Reviewed

For this report, we examined USC's affiliation with four foundations which include: (1) the Carolina Research and Development Foundation; (2) the Educational Foundation; (3) the Business Partnership Foundation; and (4) the Richland Memorial Hospital/USC Foundation. The following section briefly describes these foundations.

Carolina Research and Development Foundation

This foundation is organized exclusively "for the benefit of, to perform the functions of, or to carry out the purposes of the University of South Carolina" This includes obtaining and providing property in accordance with the needs of the university and promoting and encouraging scientific investigation and research at the university. According to the foundation's by-laws, all funds and income, after operating expenses, must be used to benefit the university. The foundation had assets of \$59 million as of June 30, 1987.

Educational Foundation

The objectives of this foundation are to "establish and implement a long range program of fund raising to assist in the expansion and improvements of the educational functions of the University of South Carolina." As of June 30, 1987, the foundation had assets of over \$22 million.

**Business Partnership
Foundation**

The main purposes of this foundation according to its by-laws are:

To establish a continuing partnership between the University of South Carolina and the business community of the State of South Carolina for the enhancement and improvement of the College of Business Administration; to solicit and receive gifts subject to conditions imposed thereon for the benefit of the College of Business Administration; to build an endowment fund and supervise its creative management; to assist in determining appropriate projects to be financed with funds raised; to encourage and assist in supporting research in business and economic problems; and to assist in conducting conferences for education and development of management personnel in South Carolina and in the Southeast.

As of June 30, 1987, the foundation had assets of approximately \$4.9 million.

**Richland Memorial
Hospital/USC Foundation**

The purposes of this foundation are to support education, service, research and development in the health sciences, and in the fields of preventive and curative medicine. The foundation is supported by revenue from the clinical faculty practice plan of the USC School of Medicine. At the end of calendar year 1987, the foundation had assets of approximately \$2 million.

Foundation Organization and Fund-Raising

We examined the locations, board memberships, and fund-raising of foundations associated with USC. The Carolina Research and Development Foundation and the Educational Foundation are located in rental property near the campus of the University of South Carolina. The foundations have their own telephone systems, computer terminals and photocopying equipment. Written contracts govern five USC employees who work for these two foundations. The cost of their salaries and fringe benefits is covered by the foundations. The Educational Foundation's use of USC's computer and systems analysts is also reimbursed at full cost. The Richland Memorial Hospital/USC Foundation is located off campus, and we could not identify any state funds used to support the foundation. The foundations' locations off-campus, reimbursements made by the foundations to USC, and the existence of written contracts between the parties indicate that many aspects of the university--foundation relationship are independent of each other. USC stated that the foundations have become more independent since 1983, in response to previous recommendations of the Audit Council.

According to the April 1987 by-laws, the offices of the Business Partnership Foundation "shall be the same as the Dean of the College of Business Administration of the University of South Carolina." The Business Partnership Foundation has a 99-year lease of the eighth floor of USC's College of Business Administration Building in return for \$2 million in previous contributions and payments to USC. Under the lease, USC pays all maintenance, utilities and taxes except for telephone charges. The foundation reimburses USC for any direct costs associated with the foundation's continuing education programs. No written contract governs the use of a USC employee who works for the Business Partnership Foundation. However, according to USC officials, the foundation does reimburse USC for the salary and fringe benefits of this employee. Accounting services are handled by a private firm.

Selection of Foundation Board Members

1. Carolina Research and Development Foundation

The Audit Council reviewed the methods by which foundation board members are selected to determine the degree of independence between the foundations and the University of South Carolina. State law does not govern the methods by which foundation board members are chosen. The following explains how four USC foundations select board members.

According to the foundation's 1986 by-laws, (the most recent ones made available to the Audit Council), all Carolina Research and Development Foundation directors, except for USC's president, are selected by either USC's president or the USC Board of Trustees. The foundation's board consists of:

- One individual named by and from the USC Board of Trustees;
- USC's president serving in an ex officio capacity with voting privileges;
- Two individuals named by USC's president; and
- Nine individuals named by the USC Board of Trustees.

According to the university, USC's president has resigned from this position. Because of the way the Carolina Research and Development Foundation is classified by the IRS, the IRS requires the board to have university involvement.

Both the executive director and the fiscal officer of the foundation are USC employees. (These two individuals also serve as executive director and fiscal officer of the Educational Foundation.) No USC administrators or staff currently serve on the board of the Carolina Research and Development Foundation.

2. Educational Foundation

According to the 1979 by-laws of the Educational Foundation (the most recent ones made available to the Audit Council), the board consists of not more than 27 members, at least 16 of whom cannot be USC employees. Directors are elected by majority vote of the foundation's board of directors. The by-laws state that there are five ex officio members, including the president of USC, the chairman of the USC Board of Trustees, one member of the USC Board of Trustees, the president of the Alumni Council, and the chairman of the Chair Endowment Committee. Ex officio members have full voting rights. According to the university, USC's president has resigned from this position. No university administrator currently serves as a director of the Educational Foundation.

3. Business Partnership
Foundation

The foundation is governed by a 30-member board of trustees. Two of the thirty must be trustees of the University of South Carolina, selected by the USC Board of Trustees. Twenty-five are business people elected by majority vote of the foundation trustees. The president of USC, the vice president for development at USC, and the dean of the College of Business Administration serve as ex officio members without voting rights.

4. Richland Memorial
Hospital/USC Foundation

The RMH/USC Foundation Board of Directors consists of the chairman of the RMH Board of Trustees, the chairman of the USC Board of Trustees, USC's vice-president for development, the chief of staff of RMH, the president of RMH, the executive vice-president for educational affairs of RMH, the dean of the USC School of Medicine, and the associate dean for medical services. These are voting members. The chairmanship of the board alternates yearly between the chairman of the USC Board of Trustees and the chairman of the RMH Board of Trustees.

Conclusion

State law does not address the composition of foundations established to benefit universities or state agencies. However, in the case of the Carolina Research and Development Foundation, the IRS requires the board to have university involvement. When a foundation board is selected entirely by the university with which it is affiliated, as is the case with the Carolina Research and Development Foundation, the relationship is not totally independent. To mitigate any potential problems which might arise from this connection, a greater degree of state oversight of agency-affiliated foundations is needed.

Relationship Between USC Staff and Foundations

University of South Carolina administrators have received salary supplements from university-affiliated foundations. University employees also perform a variety of administrative functions for these foundations. Issues concerning these relationships are discussed below.

University Employees Working for University Foundations

An employee of the University of South Carolina serves as executive director of both the Carolina Research and Development Foundation and the Educational Foundation. Another university employee is their fiscal officer. This second university official is responsible for determining which discretionary expenses (see p. 43) USC will pay and which ones the foundations and other parties will pay.

According to these individuals, they do not allocate their time or keep records indicating the percent of time spent working for the foundations. They stated that they either work overtime or their work for the foundations takes very little time.

In addition to those university employees serving as officers of foundations, one administrative employee of USC spends half of each day working at the USC Office of Alumni and Development (Development Office) and the other half at the offices of the Educational Foundation. The Educational Foundation does not

reimburse the university for this employee's salary or benefits, and there is no contract to govern this relationship.

Staff of USC's College of Business Administration perform fund-raising and administrative duties for the Business Partnership Foundation as part of their job functions. For example, the liaison between USC and the Business Partnership Foundation is a full-time university employee. Another College of Business Administration official and the official's secretary estimate that they each spend approximately 90% of their time raising funds for the foundation. The foundation does not reimburse USC for the costs of their time. Since these individuals do not keep time logs, the extent of their foundation work conducted on state time cannot be precisely determined. We could find no authority in state law which allows state employees to perform services for private foundations at state expense.

Potential Conflicts of Interest

University employees receiving salary supplements from a foundation could lead to a conflict of interest, making it difficult for the employees to be fully accountable to all concerned parties. We identified four USC administrators who received over \$80,000 in salary supplements which ranged from \$15,000 to \$54,000.

USC's foundations are single-purpose foundations chartered exclusively to benefit the University of South Carolina. However, when the interests of private foundations and the university do not coincide, as may be the case with a lease described on page 26, and a university employee receives a financial benefit from a foundation, there is a potential to act in the interest of the foundation at the expense of the state. The potential conflict of interest is increased when the individual receiving the supplement serves as an officer of the foundation supplementing his salary. Some state scrutiny of foundation records might detect any conflicts of interest.

The Budget and Control Board's Division of Human Resource Management Regulation 19-702.09 states:

No state employee may accept any work or remuneration that could be reasonably construed as a conflict.

Section 129.9 of the FY 88-89 Appropriation Act also states:

... salary appropriations for employees fixed in this Act shall be in full for all services rendered, and no supplements from other sources shall be permitted or approved by the State Budget and Control Board.

However, the Attorney General's Office ruled in a 1978 opinion that compensation of university employees from private sources does not violate the Appropriation Act.

Fund-Raising Support for Foundations

We examined USC's involvement in fund-raising for its affiliated foundations. Fund-raising for the Business Partnership Foundation is conducted primarily by College of Business Administration staff and is considered part of their job duties.

Funds for the Educational Foundation are raised by the University's Office of Alumni and Development and also, informally, by the foundation's board. The president of USC also functions as a fund-raiser for university-affiliated foundations. The Carolina Research and Development Foundation does not specifically solicit monetary contributions. It functions more as a vehicle for grants and construction projects. The following describes in more detail the use of state resources to support foundations.

Office of Alumni and Development

The University of South Carolina expends state-appropriated resources to raise money for the Educational Foundation. The USC Development Office solicits funds, including annual giving, corporate gifts, major gifts from individuals, and bequests. USC has not maintained records on the amount of staff time spent raising funds that are given to a private foundation. However,

an Audit Council review of USC records indicates that approximately 66% of the Development Office's staff time is spent in fund-raising. Based on the proportion of funds raised by this office for foundations, we estimate that over \$600,000 of the approximately \$900,000 annual budget was spent soliciting contributions for a foundation. This estimate does not include the value of office space used for fund-raising. The foundation reimbursed the university less than \$93,000 for the university's fund-raising support.

We could find no provisions in state law which allow state agencies to expend state resources for private organizations, even if the organization reimburses the state for expenses incurred.

The use of state resources to subsidize a private organization reduces accountability in several ways. First, foundation records are not audited by the state or otherwise available for public review. When appropriated funds support private foundations, the university can no longer determine how those funds are spent. Second, the foundation, as a private organization, is not required to comply with state regulations pertaining to travel, entertainment, or other types of expenditures, excluding procurement of capital improvement projects. Foundation records are also not audited by the state or otherwise available for public review.

USC School of Medicine Clinical Faculty Practice Plan

The Clinical Faculty Practice Plan (CFPP) allows the USC School of Medicine faculty to earn additional income above their teaching salary by seeing private patients. This concept is common at medical schools across the country. The USC School of Medicine operates its practice plan in conjunction with Richland Memorial Hospital. All clinical faculty at the medical school are required to participate in the practice plan.

While faculty participation in the CFPP is required, the plan is not required to be reviewed or approved by the Commission on Higher Education (CHE) or the Budget and Control Board. The plan does require approval of the USC Board of Trustees. The CFPP specifies that the fees it generates are to be deposited into

nonstate department accounts, such as pediatrics, surgery and neonatology. The fees are used to pay for the operating expenses of the practice plan. Under the practice plan, operating expenses include the additional compensation for the physicians, as well as rent, telephone and administrative costs. Any funds remaining after operating expenses are paid must be transferred to a private foundation, the Richland Memorial Hospital/USC Foundation, whose purpose is to aid education, service, research and development in the health sciences and medicine. The following summarizes revenues and expenditures for this foundation in 1987.

Practice Plan Fees
Support Foundation

In 1987, the CFPP generated approximately \$9 million in revenue. The RMH/USC Foundation received \$1.65 million of the revenue. The remaining \$7.35 million was used for CFPP operating expenses, including \$3.1 million for additional physician compensation.

In 1987, foundation expenditures totalled approximately \$1.4 million according to the financial statement of the foundation. Expenditures included:

- \$500,000 contributed to the RMH building fund for a cancer research center;
- \$226,467 in salary reimbursements;
- \$203,174 in equipment purchases;
- \$100,000 contributed to the USC School of Medicine; and
- \$82,819 for conferences, seminars and continuing education.

Because the foundation is a private entity, expenditures are not subject to state audit. The State Appropriation Act does allow for state audit of the practice plan.

While the practice plan must be approved by the USC board, neither the Commission on Higher Education nor the Budget and Control Board are required to approve the plan. In Florida,

practice plans must be approved by the State Board of Regents. None of the surveyed medical schools in the eight southeastern states have a private foundation receiving support from a practice plan. The practice plan of the Medical University of South Carolina in Charleston does not provide funding for a foundation.

Disposition of Donations

The relationship between the University of South Carolina and its affiliated foundations cannot be fully understood by considering only the contractual and financial aspects. The university also provides support to the foundations in other ways. The university indicates that it directs gifts to the appropriate recipient, which could be either the university or its foundations. The 1986-1987 USC Annual Report states that the USC Development Office:

Directs all gifts to the appropriate support vehicles such as the USC Educational Foundation, the USC Business Partnership Foundation, the Carolina Research and Development Foundation, the Office of Sponsored Programs and Research, all campuses and campus-related foundations.

According to the Development Office, there are approximately 1,300 separate accounts for donations. Most of these are within the Educational Foundation, including ones for many academic departments and schools, library accounts, and memorial scholarship accounts. Smaller gifts usually go to existing accounts within the Educational Foundation.

University officials have also indicated that, in the case of major gifts, the Development Office will work with the donor to evaluate his or her wishes. According to an official of the Development Office, many people want their donations to be given to the Educational Foundation. These practices indicate that the university has some latitude in determining whether donations are made to the university itself or to its affiliated foundations. This may reduce the number of contributions which are made directly to the university and are, therefore, subject to state oversight.

Shared Identity

The university often considers its single-purpose foundations to be a part of the university. This relationship is illustrated by procedures for soliciting donations to the foundations. Potential donors to the USC Educational Foundation's Annual Fund are sent a postage-paid envelope addressed to the University of South Carolina in which to return their pledges. In addition, the acknowledgements thanking donors for gifts to the foundation are printed on University of South Carolina letterhead stationery or acknowledgement cards. The acknowledgement for gifts of less than \$100 states "The University of South Carolina gratefully acknowledges your gift in support of its academic programs," even though the gift was made to the foundation and not to the university itself.

Another example of how the university considers the foundations to be a part of the university is found in USC's *Report of the President 1977-86*. This report states:

The largest gift to the Summit Fund campaign, the *transfer to USC of Pritchard's Island* . . . exemplifies how the campaign helped strengthen the University's academic programs. [*Emphasis Added*]

A 50% interest in this island, however, was donated not to the university, but to the Carolina Research and Development Foundation.

Recommendations

- 1 The General Assembly may wish to consider clarifying whether state employees are allowed to solicit funds for private foundations, perform services for private foundations, or expend state resources for private foundations. If the General Assembly chooses to expressly authorize this practice, legislation requiring foundations to repay the state for all fund-raising and other expenses incurred should be enacted. Work should be performed pursuant to written contracts and appropriate work records should be maintained.

- 2 To improve oversight, the General Assembly may wish to consider requiring that salary supplements, financial support, or reimbursements to state employees be disbursed through agency accounting systems.
- 3 The General Assembly may wish to consider enacting legislation requiring that the Budget and Control Board or the Commission on Higher Education approve the terms of medical school practice plans.
- 4 USC should properly report the disposition of gifts given to the university and its affiliated foundations.

Business Transactions

The University of South Carolina has a range of business relationships with the Carolina Research and Development Foundation. These include construction projects and leases. The university has also entered into an agreement with an independent theater. Issues arising from these relationships are discussed in this chapter.

State Funding of Private Projects

The Audit Council examined two University of South Carolina projects which were intended to be entirely funded through private contributions to a USC-affiliated foundation. In addition, we examined the expansion of an existing program which was also to be privately funded. However, after the projects were begun, USC requested state funds in order to complete the projects. USC is obligated to expend up to \$10 million on two building projects being constructed in conjunction with a university-affiliated foundation. In addition, USC plans to expend up to \$3.2 million on a project with an independent theatre. These funds will be expended over a 5- to 12-year period.

The total cost of these three projects is estimated at \$49 million. Thus, the state's commitment of up to \$13 million will make up the smallest portion of the total cost of these projects. In addition, USC officials have indicated that the state's contribution towards these projects may be reduced if USC is successful in obtaining additional private support.

The Audit Council did not examine the merits of these projects. The development and financing of these projects and problems associated with USC's leasing of a building from a university-affiliated foundation are described in the following pages.

Project 1 - Development of Fine Arts Center

Plans for the development of an 800-seat fine arts center began in the late 1970s. When USC officials realized they would be unable to secure state funding for the center, they began to search for private funding. After securing a private pledge of between \$4 and \$5 million, sufficient to build the 800-seat

center, USC was approached by city and county officials seeking an expansion of the center to over 2,000 seats in order to serve a larger community.

The cost of the expanded Koger Center was estimated at \$15 million, approximately \$10 million more than the original center would have cost. However, according to an April 1987 letter from the foundation's executive director to a state senator, even with the expansion, USC assumed it would only have to contribute the private gift and that no state funds would be needed for the project.

State Involvement in the Fine Arts Center

State funds for the Koger Center became necessary for two reasons. First, the city and county's contribution amounted to \$5.75 million. This amount, when combined with the private pledge of \$4 to \$5 million, (including a \$2 million irrevocable trust to be paid upon the donor's death), left a shortfall in construction costs of approximately \$5 million. Second, funds were needed to cover the interest charges on a loan that the foundation had to secure because construction of the center would be completed prior to the receipt of all the donations.

While continuing to seek private funding to cover these costs, USC approached state officials requesting state funds for the center. USC officials received approval from the Commission on Higher Education (CHE) to enter into a lease agreement with the foundation to assist it in covering the shortfall and paying the interest charges. The lease itself was approved by the Budget and Control Board and funding for the lease was a separate line item in the Appropriation Act beginning in FY 86-87.

CHE has approved lease payments of up to \$8.025 million over 12 years. According to documents supplied to CHE by USC in 1985, it is estimated that if the full \$8.025 million approved by CHE is spent, approximately \$4 million would be for construction costs and \$4 million for interest charges.

In a 1985 letter to CHE, university officials stated that the lease payments may be shortened if USC is successful in raising additional private donations. As of June 30, 1988, the center had received additional private pledges of \$1.7 million, leaving a funding shortfall of approximately \$3.55 million.

Project 2 - Development of Engineering Center

Plans for the construction of an engineering building date back to at least 1979. In 1979, CHE deferred a USC request to build an engineering building using \$12.5 million in state capital improvement bonds and \$1.5 million in private pledges. In 1985, construction began on an engineering building for USC. According to the USC *President's Report 1977-86*, the engineering building was to be "... completely financed with contributions from the private sector." Construction was to be financed by a university-affiliated foundation using \$16.7 million in private pledges.

After construction began, the foundation received a federal grant (\$16.3 million) which allowed the project to expand to a \$30.8 million Energy Research Complex. The complex included the engineering building as well as another building, and plans for the Graduate Science Research Center. The foundation used the federal grant, in part, to pay off the foundation's construction loan. This enabled USC to terminate the lease with the foundation (for a discussion of the lease see p. 24).

The expansion of the engineering building, which originally was to cost \$16.7 million and involve no state funds, has evolved into a \$30.8 million Energy Research Complex to be built with a combination of private, federal and state funds.

State Involvement in
Engineering Center

According to a July 1, 1985 letter from USC to CHE, USC needed state funds for the engineering building for two reasons.

First, it provides security necessary to obtain the best possible financing at the satisfaction of the lenders. Secondly, it provides bridge money to cover the gap between construction and receipt of the gifts.

Principal and interest payments were to be paid with public funds through a lease agreement between USC and the foundation. CHE approved a five-year lease totalling \$6.03 million.

A year after the lease went into effect, the foundation received a \$16.3 million federal grant to assist in funding the engineering building. The foundation paid off the construction loan, terminated the lease with USC and deeded the center over to USC. *Terminating the lease allowed USC to save the state over \$4 million in future lease payments.*

Principal and Interest Paid by
USC

The USC president, when requesting CHE approval to enter into the lease agreement with the foundation, stated that once the foundation loan had been satisfied, "... pledge payments will be deposited to USC up to its capital portion of the lease payment contribution." CHE and the Budget and Control Board approved the lease but no provision was placed in the lease requiring the capital portion of the lease to be repaid to USC. USC paid the foundation \$1.715 million over the term of the lease, \$1.077 million in interest charges and \$639,000 as its capital portion of the lease payments.

As of September 1988, the foundation had not repaid to the university the \$639,000 capital portion of the lease payments as specified in the July 1, 1985 letter to CHE. This includes \$262,000 in formula funding for interest charges above what was actually expended for interest charges.

Project 3 - Agreement With an Independent Theatre Organization

USC has expended \$800,000 in state funds on a contract with an independent theatre organization which was originally intended to be paid with private funds. In addition, USC has renegotiated the original contract and committed an additional \$2.4 million in state funds over the next eight years. Because this project was an expansion of an existing program, CHE approval was not necessary.

In 1986, USC entered into an agreement with an independent theatre organization in which \$2.6 million in payments were to be made to the theatre over six years. In exchange, the theatre would provide internships for USC students at the theatre and instructors to teach at USC each semester. At the time the agreement was entered into, USC anticipated that a private source of funds would be used to make the \$2.6 million in payments. The *USC President's Report 1977-86* states, "The agreement provides for up to \$500,000 per year . . . with funds made available from a private anonymous source designated for the purpose."

The private funding, however, failed to materialize and USC used \$800,000 in state funds to pay for the cost of the first two years of the contract. The contract had a termination clause which allowed USC to terminate the contract after two years if private funding did not materialize. Rather than terminate the contract, USC officials decided that the agreement was a valuable addition to the theatre program at USC and renegotiated the original contract. The new contract, effective August 1988, requires USC to pay the theatre \$2.4 million over the next eight years. Thus, the original six-year agreement, which was to have been entirely privately funded, has become a ten-year commitment funded by up to \$3.2 million in state funds.

Summary

The two building projects and the expansion of the existing program, which were originally intended to be privately funded, have cost the state approximately \$4.5 million as of July 1, 1988. In addition, the state could expend up to \$13 million before the projects are completed. While these projects should result in approximately \$49 million worth of buildings and services to the

state, state officials were not made aware of the need for state funds for the construction projects until after USC received permission for the foundations to start the projects. State officials also have not been able to maintain adequate oversight of the projects because of the involvement of a private foundation in two of the three projects.

Terms of Leases

Leases between the University of South Carolina and the Carolina Research and Development Foundation for the Koger Arts Center and Swearingen Engineering Center contain terms unfavorable to the state. These leases were not presented to the Division of General Services for input into their drafting as required by Budget and Control Board Regulation 19-445.2120. The Budget and Control Board did approve the leases, however. The Swearingen Center lease terminated early and title to the property has been conveyed to the university. Although both leases are similar, issues concerning the Koger Center lease are discussed below since the lease is still in effect.

Renewal Option

The Koger Center lease contains renewal options which could obligate the university to extend its lease payments indefinitely if the foundation has not collected pledges or otherwise obtained enough funding to repay its construction debt. The clause is significant because, when the Koger Center project began, the foundation needed an additional \$5 million in pledges or contributions to pay for the project. Therefore, public funds could be obligated to retire the foundation debt.

The Koger Center lease renewal clause states:

If the indebtedness . . . is not retired in full on or before December 31, 1991, it is understood that the Foundation will expect the University to renew this Lease on terms and conditions which will enable the Foundation to repay the indebtedness in full.

The foundation has declined the Audit Council's request to review its records. Therefore, we could not verify the status of

the foundation's construction debt, on which USC's contingent obligation to renew the lease is based.

**Application of Lease
Payments to Foundation
Debt**

The Koger Center lease does not require that a portion of the rental payments be applied to the foundation's construction debt, although USC's president has stated they would be used for this purpose. Without such terms in a lease, and without access to foundation records, the state has no knowledge of or control over the disposition of rental payments.

**Lease Cancellation
Clause**

The Koger Center lease also provides that if the university cancels the leases for lack of funds, title to the property will not be transferred to the university. This conflict between the terms of the leases and the potential availability of state funds would result in a dilemma for the state, if the foundation invoked the renewal clause on the Koger Center lease. Either the state could lose title to the property after paying millions of dollars on the lease (see below), or additional funds would have to be provided to USC for its lease payments.

**Option to Purchase Prior
to Expiration of Lease**

At the expiration of the Koger Center lease, if the foundation's debt is fully paid, title will be conveyed to the university. However, the lease contains no option to purchase the property prior to expiration of the lease.

**Recalculation of Rent
Clause**

The president of the University of South Carolina has stated that if additional contributions for the Koger Center are received, lease payments might be reduced (see p. 23). However, the lease itself contains no provision for reducing the university's annual rent payments.

Other Lease Terms

The terms of the Koger Center lease require the university, not the foundation, to comply with all state laws on barrier-free design. If the premises do not comply, the university must pay for such repairs or alterations as are necessary. The lease also requires the university to provide insurance coverage on the premises, even before occupancy (see below).

Lease of Unconstructed Building

The University of South Carolina has paid the Carolina Research and Development Foundation approximately \$800,000 per year to lease the partially constructed Koger Center. An estimated \$2 million was paid to the foundation before the university could occupy the building. The university was also required to pay for builder's risk insurance prior to its use or occupancy. In 1985, the Facilities Committee and Business and Finance Committee of the Commission on Higher Education recommended approval of a lease for the \$15 million Koger Center. The lease was to begin January 1987, the projected completion date of the center. However, when the lease went into effect, its terms required USC to make its first lease payment in September 1986, although the building was not scheduled to be completed until December 1988.

According to a memorandum of agreement between the Commission on Higher Education and the university, the lease was necessary to allow the Carolina Research and Development Foundation to pay interest on its construction loan until private contributions could be collected. There are no statutes or regulations which prevent an agency from making lease payments on unconstructed buildings. However, when a state agency makes lease payments on unconstructed or partially constructed buildings, it subsidizes the foundation developing the property. Furthermore, the tenant does not receive the usual benefit of a lease, which is occupancy of the premises.

Conclusion

The University of South Carolina has entered into a lease containing terms which are beneficial to a private foundation but do not fully protect the state as a tenant. In contrast, another state university, in consultation with the Division of General Services, entered into a lease purchase agreement with an affiliated organization. Its lease contains the following:

- A requirement that a portion of the rental payments be used to reduce the developer's construction debt;
- An option to purchase which allows the university to purchase the property prior to the expiration of the lease;
- A provision that if the construction debt is reduced, the university's base rental fee must be reduced; and
- A provision that rental payments would not begin until the building was completed.

When leases are negotiated without input from the Division of General Services as required, the state may pay more than is necessary.

Recommendations

- 5 USC should request that the foundation, as originally intended, return funds used for non-interest costs associated with the construction of the engineering building projects.
- 6 The Division of General Services should promulgate regulations governing state agencies' leasing of facilities under construction. All leases should be drafted with the assistance of the Property Management Office of the Division of General Services.

Foundation Oversight and Compliance Issues

In order to be exempt from state audit and oversight requirements, foundations must be separately chartered from the state agencies with which they are affiliated. Though foundations are exempt from audit by South Carolina governmental auditors, some oversight is provided by the Secretary of State. Section 33-55-40 and §33-55-70 of the South Carolina Code of Laws specify that charitable organizations must register with the Secretary of State. The foundations we examined are in compliance with these requirements.

Nonprofit organizations soliciting funds from the public are also required to submit annual financial statements to the Secretary of State. These statements evaluate the foundation's conformity with the generally accepted accounting principles, and account for changes in fund balances. Expenditures are reported in general categories such as "fund raising" and "other expenses." These statements do not provide enough detail to allow an evaluation of whether transactions between the foundations and the University of South Carolina are in compliance with state statutes and regulations, and foundation by-laws. The Educational Foundation, the Carolina Research and Development Foundation, and the Business Partnership Foundation have filed annual financial statements. The Richland Memorial Hospital/USC Foundation is not required to file a financial statement because it does not solicit funds.

This chapter addresses oversight and compliance issues. They include lack of access to foundation records, foundation compliance with the Appropriation Act's proviso on reporting contributions to the Koger and Swearingen Centers, and reporting of university salaries supplemented by private foundations.

Access to Foundation Records

In an attempt to fully understand and better report to the General Assembly the relationship between USC and its affiliated private foundations, the Audit Council requested access to certain records of USC's largest foundation. The foundation's legal staff responded:

Because of its status as a private entity, [The Foundation] does not feel that it is appropriate to provide the Legislative Audit Council with access to its records.

The following are examples of areas of foundation activity which are not subject to state review:

- Whether foundation funds are being used to entertain or purchase gifts for public officials. [There are limitations pertaining to the amount that can be spent on gifts for federal and state officials.]
- The status of private contributions given to a foundation to fund construction projects which will be deeded to the university (see p. 34).
- The extent of the state's liability if contributions to the Koger Center do not come in on time or are not applied to the reduction of the construction loan (see p. 26).
- If any conflicts of interest exist as to university officials serving on, or working for, foundation boards.

In South Carolina, foundations and endowments whose sole purpose is to support state universities or agencies can be established so that they are exempt from state oversight. If they have a separate legal charter, they are not necessarily subject to state Freedom of Information laws or other laws which govern state agencies, excluding state purchasing laws.

Endowments and other mechanisms for financial support can be established in ways that provide for more extensive state and university oversight. For example, the Athletic Department collects membership dues for the USC Gamecock Club, a tax exempt department of the university with a separate board of directors and by-laws. The USC Board of Trustees has final authority over how the contributions are expended. In FY 86-87, the Gamecock Club raised over \$4.4 million for USC athletic programs. Gamecock Club financial records are maintained by the university and are audited by the State Auditor or his designee on an annual basis.

Other States

Laws and regulations governing state oversight of foundations vary in other states. A survey conducted by the Connecticut Commission on Higher Education found that of the 36 Commissions on Higher Education responding, 14 have some degree of statutory or regulatory authority to oversee foundations. An Audit Council survey of eight southeastern states showed that auditing groups in all eight states have greater access to foundation records than do auditing groups in South Carolina. The following summarizes our survey of other states.

Florida

Florida's Auditor General's Office staff stated they can perform audits of state agency-affiliated foundations.

Tennessee

In Tennessee, a State Board of Regent's policy states:

Records and accounts maintained by the foundation[s] shall be audited annually by the Comptroller of the Treasury or with the prior approval of the Comptroller of the Treasury, an independent public accountant.

The University of Tennessee is exempt from this policy.

North Carolina

North Carolina state law allows the State Auditor access to the records of a foundation insofar as they involve transactions with a state agency.

Virginia

In Virginia, a proviso in the Appropriation Act makes any entity receiving appropriated funds subject to audit by the Auditor of Public Accounts. The Joint Legislative Appropriations Review Committee has access under its enabling legislation.

Alabama

The Alabama Examiner of Public Accounts informed the Audit Council that they would have access to foundation records of a project where state money is involved in business transactions.

Mississippi

In Mississippi, officials with both the State Auditor and the Performance Evaluation and Expenditure Review Committee stated they would have access to foundation records on a project where state money is involved.

Kentucky

The Kentucky Auditor of Public Accounts informed the Audit Council that they have access to foundation records where state money is involved in business transactions.

Georgia

Georgia's State Auditor has access to "the books and records" of university-affiliated foundations under their "open records law."

In 1987, South Carolina's procurement code was amended to require that private foundations using public funds for a capital improvement project follow the state procurement code.

While USC's affiliated foundations are not subject to state oversight, oversight is provided by foundation boards and an annual financial audit by a private accounting firm.

Recommendations

- 7 The General Assembly may wish to consider amending state laws to allow for more oversight of private foundations which support state agencies. This may include requiring foundations to be subject to the Freedom of Information Act and review by the Legislature and state oversight agencies.

- 8 As an alternative, if state funds are used to fund any part of a foundation project, state access to related records of the foundation should be allowed.

Oversight of Private Contributions

The State Appropriation Act requires USC to report certain information concerning pledges made to the Carolina Research and Development Foundation for the Koger and Swearingen Centers. An examination of the information provided indicated noncompliance with part of the act. The following discussion of USC's compliance with the Appropriation Act and the status of private pledges is based on USC files, interviews with USC officials, and information provided to the Budget and Control Board.

Compliance With Appropriation Act

The University of South Carolina has not fulfilled all reporting requirements of the FY 87-88 and FY 88-89 Appropriation Acts on the status of private pledges for the Koger and Swearingen Centers. In addition, the Audit Council was unable to verify the information that USC did provide to state officials because a university-affiliated foundation did not allow the Audit Council access to its records (see p. 35).

Section 25.7 of the FY 87-88 Appropriation Act and Section 25.6 of the FY 88-89 Appropriation Act required USC to report to the B&C Board on the status of the private pledges for the Koger and Swearingen Centers. Two reports are required each year, one in August and one in October. The August report requires USC to submit a list of individual contributors, identified by code number, along with the amount to be contributed and the agreed or anticipated date of payment.

In August 1987, USC submitted a report which did not list all the contributors for the Swearingen Center individually. Contributors who had already paid the entire amount of their contribution were combined into one sum. The remaining seven contributors were not assigned code numbers. The code numbers are necessary for the B&C Board to track the status of

the pledges over time. In addition, there was a \$310,000 error in the amount of private contributions reported for the Koger Center.

USC sent the August 1987 report to the State Auditor assigned by the B&C Board to monitor compliance with the provisos. The State Auditor returned the report with suggestions for revisions. USC did not revise the report.

The August 1988 report did list the individual contributors for the Koger Center by code number with the anticipated date of payment. A similar list was not prepared for the Swearingen Center. According to a USC official, because the debt on the Swearingen Center had been retired, the report was no longer necessary. However, the private pledges which were not received prior to the completion of the Swearingen Center are now to be used to fund other projects in the "Energy Research Complex" (see p. 23). Therefore, to complete the energy complex as desired, it is essential that private pledges be collected.

The reports due in October 1987 and October 1988 required USC to report to the B&C Board its progress in receiving individual contributions as compared with the original schedule and to project any future changes in receipt of the pledges. In addition, a "public summary" detailing the amount of contributions for the projects in each year, any current or anticipated shortfall in private pledges, the effect of any shortfalls on USC's institutional budget and the precise amount of state funds required for each project is to be included. USC did not file a report in October 1987. The October 1988 report did not list the progress in collecting contributions for the Koger and Swearingen Centers by individual, nor did it compare this progress with the original schedule. Without this information, the B&C Board cannot properly monitor these projects.

Status of Private Pledges

In an attempt to verify the pledge information provided the B&C Board, the Audit Council requested from USC the data used to compile the B&C Board report. USC replied in a letter dated August 9, 1988 that the report was prepared " . . . on the basis

of oral information supplied by a number of individuals” USC officials stated that any information pertaining to pledges would be maintained by the foundation. In addition, while the USC president was involved in the solicitation of these contributions, all information pertaining to the contributions is maintained by a university-affiliated foundation. The foundation did not allow the Audit Council access to its records (see p. 35).

Swearingen Center Pledges

According to USC records, the amount of private pledges for the Swearingen Center has declined from \$16.7 million in 1985 to \$14.5 million in 1987. According to USC officials, the decline in the amount of private pledges is not due to the attrition of contributors. Instead, USC officials state that some pledges were given in the form of stock, which fluctuates in value. As a result, the total value of the pledges may not remain constant over time.

Koger Center Pledges

The pledge schedule reported in August 1987 for the Koger Center has changed. While USC has found additional contributors for the Koger Center, the pledges received as of June 30, 1988 are \$1.465 million less than originally scheduled to be received by that time.

According to USC officials, the change in the schedule for receipt of contributions for the Koger Center is due, in part, to a local government’s decision to pay its contribution upon completion of the center rather than at the beginning as originally anticipated by USC.

Summary

Information on the status of the private pledges for the Koger and Swearingen Centers is important for several reasons. First, USC has stated to the Commission on Higher Education that if there is any attrition in the private pledges made for the Swearingen Center, desirable but optional aspects of the Energy

Research Complex will not be completed. Therefore, to complete the project as desired, pledges must be collected.

Second, once the debt on the Koger Center is retired, the lease between USC and the foundation might be terminated. If the debt is not retired at the end of the lease, USC is required to continue lease payments to the foundation or lose all interest in the facility. Also, USC officials have stated that should they be successful in obtaining additional private contributions for the Koger Center, the state's commitment could be reduced. Thus, any change in the schedule or amount of private contributions could affect when the debt is retired and how much of the \$8.025 million in state funds committed to the project could be saved.

Recommendations

- 9 USC should comply with Appropriation Acts and prepare a public summary report and a report to the Budget and Control Board on the status of the private pledges which are to be used to fund the Swearingen Center, other projects within the Energy Research Complex, and the Koger Center.
- 10 When reporting on the status of private pledges, USC should report to the Budget and Control Board any changes in the value of the pledges and the reasons for the changes.

Reporting of Salary Supplements

State law on the reporting of salary supplements needs to be clarified. Incomplete information on the salary supplements of USC employees has been provided to the Budget and Control Board's Division of Human Resource Management (HRM). In addition, it is unclear whether medical faculty at the USC School of Medicine should report income received from their participation in the faculty practice plan.

The FY 87-88 and FY 88-89 Appropriation Acts require state employees to report to HRM, "Any supplement from a public or private source" In FY 87-88, 48 USC employees reported supplements to HRM. This included faculty members with endowed chairs, administrative staff who received income from private university-affiliated foundations and medical faculty at the USC School of Medicine who participated in the Clinical Faculty Practice Plan (see p. 16). The amount of the supplements reported by all state employees ranged from \$100 to \$60,000.

In FY 87-88, USC reported 70 endowed chair holders and, according to a School of Medicine official, up to 85 medical faculty participated in the practice plan. While 48 USC employees did report supplements, as many as 107 employees, including medical school faculty, may have been required to report a supplement but did not.

In a September 17, 1987 letter to USC, an HRM official stated that it was unclear if the proviso applied to medical school faculty. However, according to the letter, " . . . if there is any possibility it could be construed as a Supplement, it should be reported." Five of the approximately eighty-five medical faculty reported receiving supplements.

In addition to an unclear definition of "supplement," the proviso also does not contain penalties for failing to report a supplement. Also, when supplements are not disbursed through the state system, the state cannot check to see that all supplements are being reported. Further, the proviso does not specify what is to be done with the information once it is collected, and if the salary information would be subject to the same provisions of the Freedom of Information Act to which state salaries are subject.

Recommendation

- 11 The General Assembly may wish to consider clarifying the proviso on the reporting of salary supplements to specify what constitutes a salary supplement, create a method to ensure compliance, and specify if salary supplement information is subject to the state's Freedom of Information Act.

Reasons for Separate Foundations

Private contributions are an important part of the long-range growth and development of the University of South Carolina. Both the University of South Carolina and its affiliated foundations can accept private donations, construct buildings, and administer research projects. Foundations can provide for greater flexibility and expertise in investing accumulated funds. Because the university and the foundations can perform many parallel functions, the Audit Council examined the various reasons for the existence of private foundations.

Protect Identity of Donors

USC has stated that foundations are necessary to protect the identity of donors. The identity of donors who give gifts to public bodies is already protected, however, by the state's Freedom of Information Act. Section 30-4-40(a)(11) of the act exempts from disclosure:

... information relative to the identity of the maker of a gift to a public body if the maker specifies that his making of a gift must be anonymous and that his identity must not be revealed as a condition of making the gift.

Greater Latitude Spending Foundation Funds

One advantage of university foundations is that they provide greater flexibility in spending. State guidelines, except for procurement of capital improvement projects, do not apply to private foundations. Therefore, foundations do not have to adhere to sometimes restrictive procurement guidelines.

**Flexibility in Meeting
Contract and Grant
Deadlines**

The university has stated that foundations are needed to allow USC to compete effectively for contracts. According to the university, if time-consuming state procedures always had to be followed, the university could not compete effectively with private universities that do not operate under the same constraints. For example, certain specialized equipment may need to be acquired as part of a research contract. This is a valid rationale for research foundations.

**Donor Restrictions on
Gifts**

USC has stated that foundations are needed to ensure that donations are used in accordance with the donor's wishes. The same objective could be achieved by setting up restricted accounts within the university. Donors' guidelines must be followed, as in the case of the recent bequest of nearly \$1 million directly to USC to support the Carolina Scholars Program.

In addition, contributors to USC's Athletic Department have donated funds for specific purposes. Funds are placed in special accounts with the State Treasurer and earn interest while on deposit.

**Donors Do Not Want to
Give to a State Entity**

The university has suggested that donors are reluctant to give money to a state entity such as the university. In such a case, foundations provide another mechanism for attracting private funding to support university projects.

**Foundation Board
Members Help Solicit
Funds**

The university has stated that soliciting funds for the foundations is an important function that prominent supporters of USC can perform. Private donations raised by supporters of the university have provided important benefits to USC, such as student aid and endowed professorships.

Fear of Reduced
Appropriations

A USC official has stated that the university is fearful that if money now donated to the foundations were given directly to the university, the Legislature would reduce appropriations. In the absence of legislation stating that appropriations to the university should not be reduced, the concern expressed by USC is understandable.

Inability to Carry Funds
Forward

It could be argued that foundations are needed because funds given directly to the state cannot be carried forward. However, the USC Gamecock Club is a tax exempt department of the university which solicits money for USC's Athletic Department. The funds are deposited into State Treasurer's accounts and are carried forward from year to year, with USC Board of Trustees' approval.

Board Must Approve
Restricted Gifts to USC

The USC Board of Trustees must approve all restricted gifts made directly to the university. The boards of affiliated foundations have assumed this responsibility for gifts made to the foundations. If the present policy for approval of gifts to USC is too restrictive, the USC Board of Trustees could consider streamlining its gift acceptance procedures for noncontroversial gifts.

Gifts Containing
Indemnification Clause

USC has stated that foundations are needed because the university cannot accept any gifts with an indemnification provision (an indemnification provision would require USC to pay for any damage or injury). The university's general counsel stated that USC has:

... on occasion incorporated such a provision [indemnification clause] in a contract at the insistence of a contracting party subject to the provision 'insofar as permitted by South Carolina law.'

Though there are occasional exceptions, this rationale is otherwise correct.

Conclusion

Under certain circumstances, there is an advantage in having a foundation, rather than the university, receive donations or enter into contracts. However, not all the reasons for this preference are equally valid. Some do not take into account the university's ability to protect the identity of donors and honor donors' restrictions on their gifts.

This analysis was conducted in order to fully report to the General Assembly the advantages of private foundations. As previously indicated, private contributions provide important financial assistance to the University of South Carolina, particularly when appropriated funds are less than 100% of full formula funding.

USC Discretionary Funds

The University of South Carolina, like other state-supported colleges and universities, generates revenue through concession sales, vending machines, game rooms, and other activities. State law allows institutions of higher learning to expend profits from these operations in accordance with policies established by the institutions' boards of trustees.

The USC Board of Trustees' policy allows the president to expend and allocate to other senior officers profits generated from five campus activities. The board's policy states, in part:

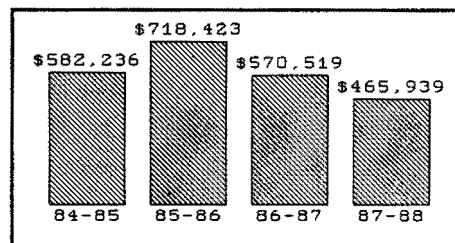
Expenditures from University Discretionary Funds may be for travel, food, lodging (over and above State-imposed limitations), student financial aid, general support for faculty/staff professional activities and for other endeavors related to the promotion of goodwill and for the advancement of the University.

This chapter analyzes discretionary fund expenditures and records maintained as confidential.

Discretionary Fund Expenditures

We analyzed the president's and senior officials' use of discretionary funds from July 1, 1984 through June 30, 1988. During that time, discretionary spending totalled approximately \$2.3 million. The following graph analyzes these expenditures by each fiscal year.

Graph 5.1: Discretionary Fund Expenditures - FY 84-85 Through FY 87-88



Source: USC records.

The following summarizes these expenditures by categories.

Food Supplies

Approximately \$679,000 was expended for food supplies from July 1, 1984 to June 30, 1988. These expenditures paid for receptions for dignitaries and for persons attending USC football games. In addition, discretionary funds paid for meals for USC staff members, members of the faculty, students, board of trustees members, state legislators, legislative committees, and members of the United States Congress.

Presidential Scholarships

Approximately \$477,000 was expended for presidential scholarships from July 1, 1984 to June 30, 1988.

Other Supplies

From July 1, 1984 to June 30, 1988, approximately \$400,000 was expended in the category of other supplies. These expenditures included gifts for dignitaries, commencement speakers, state and federal officials, and donors. Also included were flowers to decorate the president's house and flowers for funerals and illnesses. Discretionary funds also paid for tickets to football games and nonathletic events.

Contractual Services

From July 1, 1984 to June 30, 1988, approximately \$290,000 was expended in the category of contractual services. These expenditures were made to lease aircraft to transport foreign officials, visiting lecturers and guests of the university. Discretionary funds also paid for USC staff and board members to lease aircraft to travel to out-of-state football games.

Provost's Discretionary Fund

The provost was provided over \$90,000 for discretionary purposes during the four-year period examined. These funds were expended for travel, food supplies and other purposes.

Travel

Approximately \$82,000 was expended on travel from July 1, 1984 to June 30, 1988. This included student travel, domestic and foreign travel by USC officials, and travel for consultants and lecturers.

Rent

Approximately \$53,000 was spent to rent state-owned and nonstate-owned property during the four-year period examined. Discretionary funds were used to pay rent for a USC employee and for students. Funds were also used to rent apartments for state officials and visiting professors.

Miscellaneous

From July 1, 1984 to June 30, 1988, approximately \$263,000 was spent for a variety of reasons, including contributions to charitable organizations such as the Brady Foundation. Discretionary funds also paid for fireworks for the Columbia Bicentennial and a painting of the USC Horseshoe.

Confidential Records

In 1986, the USC Board of Trustees voted to keep confidential the identity of recipients of certain gifts and benefits paid for with USC discretionary funds. The following outlines problems we found when reviewing confidential records.

Nondisclosure of Certain Records

USC has not disclosed the names of certain state, national, international and other officials as well as members of certain university organizations who received gifts paid for by USC discretionary funds. Not disclosing these names violates the USC Board of Trustees' policy of keeping confidential only the identity of: (1) potential donors or contributors to the university; or (2) gifts of a personal nature which would constitute an unreasonable invasion of personal privacy.

According to board minutes dated November 21, 1986, the USC Board of Trustees voted not to disclose the names of donors or potential donors who received gifts, meals, or other items from the USC president. The USC Board of Trustees voted that:

... the disclosure of expenditures for travel, entertainment, expressions of appreciation for gifts in specific detail on a recurring basis would disclose the ongoing negotiations of such contractual arrangements for donations, gifts and Sponsored Programs and Research; such disclosure would have a direct negative impact on donors who wish to remain anonymous and in any event to have such solicitations and negotiations kept in confidence. ...

USC did not contact the recipients to determine if they wished to have their names remain confidential.

The USC Board of Trustees also voted not to disclose the identity of recipients of:

... gifts which would constitute information of a personal nature which would constitute an unreasonable invasion of personal privacy. ...

In a second resolution passed at the same meeting, the board voted to keep confidential documents relating to the solicitation of gifts and donations.

The USC Board of Trustees then directed the administration to implement the board's decision of keeping certain documents confidential.

We analyzed the 116 names of gift recipients which USC declared confidential from July 1, 1984 through June 30, 1987. No confidential gifts were given in FY 87-88 and this analysis excludes confidential recipients of meals or other services. This analysis shows that \$73,884 of discretionary funds was spent for gifts for confidential recipients. However, 69 of 116 gift recipients' names were kept confidential for reasons other than those stated in the board's policy or no reasons for remaining confidential were documented. These gifts were valued at \$50,934 or 69% of the total value of gifts given to confidential recipients. Among those receiving gifts were commencement speakers, lecturers, state officials, international government officials, wives of visiting dignitaries, and members of university advisory organizations. The following are examples of gift giving

which do not meet the USC Board of Trustees' resolutions for remaining confidential.

Graph 5:2 Examples of Confidential Gifts Given and Reason Documented for Giving the Gifts

Recipient	Cost of Gift(s)	Reason Gift Given
Member USC Board of Trustees	\$473.00	Christmas present
Officer of a USC foundation	487.00	Service
State University official and wife	667.00	No reason stated
State Legislator	200.00	Recuperation
Wife of Member of US Congress	438.50	*
U.S. Cabinet Official	460.66	No reason stated
U.S. Cabinet Official	851.26	No reason stated
U.S. Cabinet Official	564.25	In lieu of honorarium
Federal Official's wife	467.50	*
Former Federal Official	3,201.00	Lecturing at USC
Wives of visiting Ambassadors	287.00	Going away gifts
President of a foreign country	1,807.00	Lecturing
Prime Minister of a foreign country	422.50	Establishing joint relations with [a country's] university
USC advisory committee member	2,335.25	Service on Committee
USC advisory committee member	240.83	Birthday/support
USC advisory committee member	676.50	No reason stated

*Reason not reported by LAC to protect identity of recipient.
Source: USC records from July 1, 1984 to June 30, 1987.

Inconsistencies in Information Kept Confidential

USC has not been consistent in deciding which names to keep confidential. A review of names kept confidential from July 1984 through June 1987 indicated that the names of gift recipients on some documents were kept confidential while the same names were disclosed on other documents. For example:

- The identity of the Prime Minister of a foreign country who was the recipient of a gift valued at \$422 was not disclosed. He also received another gift valued at \$2,000; however, his identity in this instance was not kept confidential.
- The identity of a former United States official who received a gift valued at over \$3,201 for lecturing at the university was kept confidential. He also received a gift valued at over \$2,217 for speaking at commencement. However, information regarding the second gift was not held confidential.

- USC kept confidential the identity of an individual who received two gifts valued at \$1,252. However, other documents disclosed his name as the recipient of a gift valued at \$2,216 for speaking at commencement.
- The identity of a United States department head who received two gifts valued at \$761 was kept confidential. He also received a gift valued at \$2,216 for speaking at commencement; however, the individual's identity was disclosed in this instance.
- A Washington D.C. attorney was provided gifts and refreshments and his identity as a recipient was not disclosed; however, his name also appears on these documents as the recipient of meals.

State law allows USC the authority to expend discretionary funds in accordance with board policy. State law (no longer in effect) allowed the board to keep discretionary fund expenditures confidential. The USC board authorized the names of donors and potential donors to be kept confidential. However, according to USC officials:

. . . a significant number of University officials were working under very pressed circumstances to comply with the legal atmosphere under which the process of redaction was accomplished and, in the course of review of thousands of documents by several individuals, it is obvious that slightly varying judgments could have been made by different officials following the same general guidelines

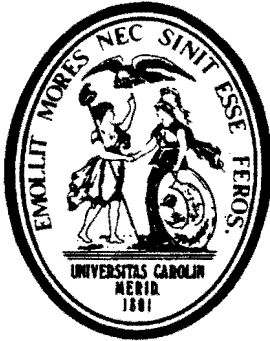
When USC keeps the identity of individuals who are not contributors or potential donors confidential, the public has less information as to how public funds are expended.

Recommendation

- 12 The USC Board of Trustees should reexamine discretionary fund documents which have been made confidential. In accordance with USC board resolutions, all redacted documents except those related to the solicitation of gifts and donations should be made public.

Appendices

USC Comments



THE UNIVERSITY OF SOUTH CAROLINA RESPONSE TO THE LEGISLATIVE AUDIT COUNCIL REPORT

JULY, 1989

The University of South Carolina is pleased to respond to the Legislative Audit Council (LAC) report focused particularly on the relationships between the University and certain of the private support organizations created for the sole purpose of furthering the mission of the University.

Although portions of the report are clearly intended to be constructive and to raise questions which can only be answered by the General Assembly, it is extremely important to note that the 1983 Legislative Audit Council Report entitled *A Review of the Relationship Between State Agencies and Associated Endowments* covered much of the same material as the current report.

The University has taken numerous steps to fashion the appropriate "arms-length" relationships with supportive foundations including positive responses to suggestions in the 1983 report.

Similarly, the University is prepared to respond positively to the current report.

State Funds in a Private Foundation Project or Program [p. 4]

With respect to the second Major Recommendation, the General Assembly has addressed this issue. It is clear to the University that appropriate state government officials should have access essential to tracking the progress and financing of, for example, construction projects which include appropriated state funds. The University will continue to cooperate with the General Assembly fully in reporting information on private pledges, as is the case with the Swearingen and Koger Centers. The University will continue, in the future, to work with the General Assembly to ensure a full understanding by appropriate state officials when state monies are used to fund any part of such a foundation project.

Subjection of Foundations to the Freedom of Information Act [p. 4]

The first Major Recommendation unfortunately ignores the history, extent, and importance of the relationship between all support foundations and their assistance to specific state institutions. It does not recognize the reality of fund raising or express an understanding of fund raising processes. This recommendation would undermine the usefulness of a single purpose support foundation and flies in the face of the Council's own recognition on page 7 that "Private gifts and contributions to USC and its foundations have greatly benefited the community." Foundations have been created across state government because they were needed for government to be more effective and efficient. They recognize the ultimate fact that donors choose the depository of their gifts. Opportunities to support a specific institution should not be arbitrarily eliminated for no substantive purpose. The University regrets the necessity of disagreeing totally with the idea of need for more oversight of foundations and of legislation mandating such increased bureaucratic interference into the *private* sector.

University Employee's Support of Foundations [p. 4]

The third Major Recommendation suggests a complete omission of any consideration of the fact that private support organizations are mandated by their charters and law to support the institution they were created to support *solely*. Any activity of a so-called "University foundation" is an activity designed for the progress and implementation of the mission of the University. The University disagrees with the recommendation that University leadership, faculty, staff, and students not be allowed to work with support groups on the University's behalf.

In fact the Council, as specifically noted below, acknowledges a role for liaison personnel and “some overlap...in personnel...”[p. 4] The basic recommendation itself is therefore illogical and crucially detrimental to the successful operation of the University and its programs.

Should the General Assembly choose to explore the issues here raised the University is ready and willing to assist in any way possible to provide — from its experience — the facts and background to explain why the concepts of potential legislation suggested by the report would be detrimental to nearly every area of state government.

USC Board Reexamination of Discretionary Fund Documents [p. 5]

The University Board of Trustees stands behind its action which quite properly and legally made certain documents confidential. The appropriateness of the Board’s action has been sustained by the General Assembly and sanctioned by the South Carolina Supreme Court. No further action is required.

Organization and Fund Raising [p. 1]

In its summary, the Council addresses the methods by which University support foundations select board members and raise funds.

The Council states, “...some overlap between USC and its foundations in personnel and functions may be desirable and in some cases required...”[p. 4] It points out that there is no prohibition in state law for USC employees to raise funds for the University. It is key to understanding the role of foundations to understand the fundamental principle on which the system operates:

USC does not raise money for its foundations. USC people, foundation volunteers and many others raise money for the University. Money raised through University-related foundations is spent only on behalf of the University. Only its educational and public service missions are enhanced.

The many benefits of private contributions to South Carolina’s colleges and universities through their supporting foundations have long been recognized by the leadership of South Carolina. As stated above, the Council’s ultimate recommendation on this matter that suggests prohibition of state employees from working with the vast array of University support groups is extremely detrimental and self-defeating. We feel it would be detrimental to other state colleges, universities and agencies as well.

Business Transactions [p. 2]

Early planning for the construction of the Swearingen Engineering Center and the Koger Center for the Arts did not include state funding. As the projects developed through the years the financial formulations changed based on the availability of various types of funding, local government funding commitments, and other factors.

In the construction of these two projects the University adhered fully to all proper procedural avenues for the appropriation of state support. All necessary and required agencies — Commission on Higher Education, Joint Bond Review Committee, Budget and Control Board, and the S. C. General Assembly — gave full and complete review and approval to state funds in the projects.

The Swearingen Center cost \$20 million; state funds were \$1.7 million. The state has benefited richly from a low cost share in project development. Similarly the combination of private, local government, and state funds has made possible the completion of the Koger Center at minimal state expense.

State Oversight and Separate Status of Foundations [p. 2]

The Council's conclusion that all of the adjacent eight southeastern states have greater access to foundation records than do auditing arms of South Carolina is simply incorrect.

The University surveyed the same eight states as did the Council and asked the same questions. None of these states have laws requiring audits of foundations by state auditors. A more realistic and responsible conclusion is that South Carolina central government bureaucracies have about the same degree of oversight and regulation of private support organizations as exists in neighboring states.

University Comments on Specific LAC Recommendations

#1. [p. 19] Higher education personnel are used in liaison roles with single-purpose foundations throughout the nation. Because each foundation serves only that institution which it is chartered to support it is not only appropriate but necessary that such coordinating functions be performed in this manner. *The University agrees that appropriate written contracts between foundations and institutions should be maintained.*

#2. [p. 20] The above mentioned concurrence that appropriate written contracts be maintained alleviates the need for this recommendation while providing public accountability about foundation activities. *The University will work with the General Assembly should it choose to address this subject further.*

#3. [p. 20] This recommendation does not seem to take full cognizance of the extreme differences in medical practice plans. Because the University does not own and operate a hospital it has a very different relationship with Richland Memorial Hospital than other medical schools have with the hospitals through which they provide patient care, particularly indigent patient care to the citizens of this state. *The University will work with the appropriate committees of the General Assembly should they wish to initiate additional study of the RMH/USC Foundation and its unique and proper contractual arrangement in the context of other medical practice plans of a different nature.*

#4. [p.20] The University has properly reported and will continue to report the disposition of gifts given to the University and related single-purpose support foundations.

#5. [p. 29] The University and the Carolina Research and Development Foundation managed the financial aspects of the construction of the engineering buildings strictly according to a carefully structured lease approved by the Commission on Higher Education and the Budget and Control Board. The General Assembly intended that the funds it allocated for the Swearingen project be expended solely for the Swearingen project and that is precisely what has occurred. The lease has been paid in full; the center has been deeded to the University with a minimal investment of state funds. The Council report points out on page 24 that the early termination of the lease "allowed USC to save the state over \$4 million in future lease payments."

#6. [p. 29] A regulation exists to govern the leasing of facilities by state agencies and educational institutions. Leases by the University discussed with respect to this recommendation were submitted by the University to the proper authorities *for their review and approval.*

It must be noted that Budget and Control Board staff make recommendations from time to time which are incorporated in USC's proposed leases prior to the approval of the State Budget and Control Board. In this case the lease of a facility under construction was the very essence

of the "bridge loan" concept endorsed by the Commission on Higher Education in 1985. The lease from the Carolina Research and Development Foundation, which had entered into tax-exempt financing arrangements on behalf of USC, required the negotiation of certain terms and conditions which were not part of the standard governmental lease. *In these leases all necessary approvals were obtained in a timely basis and it must be noted that such approvals were based upon appropriate and adequate review.*

#7. [p. 33] Please note the prior response to the first major recommendation of the Report.

#8. [p. 34] Please note the prior response to the second major recommendation of the Report.

#9. [p. 37] The University has complied with such reporting requirements and will continue to do so.

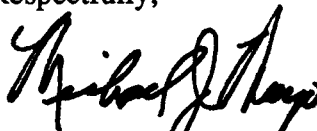
#10. [p. 37] The University respectfully submits that disclosure of specific information about confidential pledges is improper.

#11. [p. 39] *The University agrees that clarification of salary supplement information is needed and will work with the General Assembly should it choose to address this situation.*

#12. [p. 48] Please note the prior response to the fourth major recommendation of the Report.

The University sincerely hopes that the above comments are of assistance to the General Assembly as it reviews this report. Again, we are pleased to respond and will provide any additional information or assistance to the General Assembly upon request.

Respectfully,



Michael J. Mungo
Chairman, Board of Trustees
July, 1989

Commission on Higher Education Comments



SOUTH CAROLINA COMMISSION ON HIGHER EDUCATION

1333 MAIN STREET

SUITE 300

COLUMBIA, S. C. 29201

FRED R. SHEHEEN
Commissioner

TELEPHONE
803/253-6260

FAX NUMBER
803/253-6267

June 22, 1989

Mr. George L. Schroeder
Director
Legislative Audit Council
620 NCNB Tower
Columbia, South Carolina 29201

Dear George:

You have asked me to review, as the chief executive officer of an involved agency, the study by the South Carolina Legislative Audit Council entitled "A Review of the Relationship Between the University of South Carolina and Its Foundations and the University of South Carolina Discretionary Spending."

I have reviewed the report and I find it to be professionally done and also very enlightening with respect to the various transactions which have occurred between the University of South Carolina and its affiliated foundations, particularly with respect to projects and expenditures in which the Commission has fiscal or facilities oversight.

My examination of the draft report indicates that the recounting of the Commission's actions with respect to several projects is entirely accurate, and reflects the actions which took place at the Commission on Higher Education in terms of the approval process for facilities and also for payment of facilities over an extended period of time.

As you know, the relationship between foundations and institutions of higher learning in South Carolina has been a matter of some concern for the Commission over an extended period of years, and the Commission last year moved to remedy difficulties in at least one respect.

I am enclosing for your information policy guidelines adopted by the Commission last year to regulate the acquisition of facilities by foundations and third parties on behalf of the institutions of higher learning. The regulation applies to all facilities which are

Page 2
Mr. George L. Schroeder
June 22, 1989

obtained on behalf of the State institution, and the Commission's new regulation was designed to alleviate confusion and difficulties with respect to actions by the foundations and other third party agencies in the acquisition of facilities on behalf or for use by State institutions of higher learning.

Additionally, the Commission itself has been investigating the possibility of establishing an educational foundation. Mindful of the difficulties which have surrounded the operation of other foundations in the State affiliated with higher educational institutions, we have quite carefully investigated the legality and advisability of establishing such a foundation.

I am enclosing for your information the staff memorandum describing the advice we have gotten from the office of the Attorney General and other State agencies.

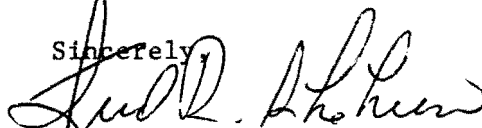
With respect to two particular projects which are discussed in the report, the Swearingen Center and the Koger Center, I am enclosing a staff report completed by the Commission on Higher Education and approved by the full Commission in 1987. Please note that under the terms of the report, which was agreed to by the officials of the University of South Carolina, there is a very clear understanding and commitment from the University of South Carolina that no further State funds beyond those initially approved would be made available for the Koger Center.

As you know, the question of relationships between foundations and public institutions of higher learning is gaining increasing attention throughout the country, and I have made available to you reports from Connecticut and Virginia which came to the Commission on this subject.

The Audit Council Report serves a very constructive purpose for higher education, and I commend you on the quality of work and on results which may ensue from the formulation and publication of this valuable contribution to the clarification of fiscal and facilities matters in higher education in South Carolina.

After the report is published, it will be examined by the Commission staff for policy and fiscal implications, and changes in procedure which might be desirable insofar as the Commission's oversight responsibilities are concerned will be submitted to the Commission on Higher Education for consideration.

Sincerely,



Fred R. Sheheen

FRS:sec

Enclosures



0 01 01 0105317 0